No. [illegible]

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

Nat Rogan, Collector of Internal Revenue for the Sixth Internal Revenue Collection District of California,

Appellant,

vs.

The [illegible] Company, Pacific Division, a Corporation,

Appellee.

Upon Appeal from the District Court of the United States for the Southern District of California.

BRIEF FOR THE APPELLANT.

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TABLE OF AUTHORITIES CITED.

CASES.

MISCELLANEOUS.

STATUTES.

No. 10279.

IN THE

United States Circuit Court of Appeals

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NAT ROGAN, Collector of Internal Rvenue for the Sixth Internal Revenue Collection District of California,

Appellant,

vs.

THE STARR PIANO COMPANY, PACIFIC DIVISION, a corporation,

Appellee.

Upon Appeal from the District Court of the United States for the Southern District of California.

BRIEF FOR THE APPELLANT.

Opinion Below.

The memorandum opinion of the District Court [R. 41-42] is unreported.

Jurisdiction.

This is an appeal from the judgment by the United States District Court, Southern District of California, rendered October 3, 1942, in favor of the plaintiff for $73,557.08, plus interest, income and excess profits taxes for the year 1934. [R. 45-46.] Appellee's complaint

sought recovery from appellant, Collector of Internal Revenue, of corporation income and excess profits taxes and interest for 1934 assessed against and paid to him by the Starr Piano Company, Pacific Division, a corporation, in the sum of $73,557.08, together with interest from the date of payment. [R. 2-9.] Appellee alleged that a claim for refund was filed on August 18, 1939, and disallowed by the Commissioner of Internal Revenue on September 20, 1940. [R. 8.] Jurisdiction was vested in the United States District Court under Section 24, Fifth of the Judicial Code. Notice of appeal was filed December 31, 1942. [R. 46, 47.] Jurisdiction is conferred upon this Court by Section 128(a) of the Judicial Code, as amended.

Question Presented.

Whether the taxpayer in 1934 realized taxable gain through the liquidation of its wholly owned subsidiary.

Statutes and Regulations Involved.

The statutes and regulations involved are set forth in the Appendix, *infra,* pages 19-22.

Statement.

The relevant facts in the case, all of which were stipulated, may be briefly summarized as follows:

In May, 1922, taxpayer caused the organization of the Gennett Realty Company under the laws of California, for the purpose of holding legal title to two 99 year leases previously acquired by the taxpayer as lessee. [R. 20-21.]

At all material times the taxpayer owned all of Gennett's stock except qualifying shares. [R. 21.] In 1922, Gennett issued bonds of $200,000 against the property and constructed a building out of the proceeds. [R. 21.] In 1922, 1923 and 1924, the taxpayer and Gennett as lessors sublet the property. [R. 21-22.] During all of its existence Gennett had no office separate from the taxpayer and had no bank account and no assets except the leases. [R. 22.] Its officers and directors were employees of the taxpayer actively engaged in carrying on the latter's activities. Its bookkeeping was done by the taxpayer's employees and its indebtedness paid by the taxpayer which credited its accounts for the indebtedness paid. [R. 22.] Rentals due Gennett under the sub-leases were collected by a Los Angeles bank as trustee for Gennett and the bank as trustee provided for retirement of the bonds and payment of interest on the same. [R. 22-23.]

For the years 1922, 1923 and 1924, the taxpayer and Gennett filed separate income tax returns. For the years 1925 to 1933, inclusive, consolidated returns were filed. [R. 23.] In 1934, taxpayer transferred accounts receivable to Gennett and the latter collected part of these accounts and turned the rest of them back to the taxpayer. Gennett carried on no other activities except those mentioned. [R. 23.]

In July and August, 1934, Gennett and the taxpayer merged under the laws of California. [R. 23.] Pursuant to the merger agreement which became effective August 1, 1934, all of Gennett's assets became vested in the tax-

payer [R. 29], and the taxpayer assumed all of its liabilities. [R. 31.] The stock of Gennett was surrendered to taxpayer's secretary for cancellation as provided in the merger agreement. [R. 31.]

The Commissioner of Internal Revenue determined that taxable gain resulted to the taxpayer through the acquisition of Gennett's assets and assessed income and excess profits taxes for the year 1934, based upon such gain. [R. 26.] It is stipulated that if such gain is recognizable for tax purposes, taxpayer is not entitled to recover while if such gain is not recognizable for tax purposes judgment should be in favor of the taxpayer. [R. 26.]

Statement of Points to Be Urged.

Appellant urges that the District Court erred in concluding (1) that taxpayer was entitled to the benefit of Section 112(b) (4), Revenue Act of 1934, and that gain resulting through the acquisition of Gennett's assets was not taxable in such year, and (2) that the entity of the Gennett Realty Company should be disregarded and ignored for tax purposes.

Summary of Argument.

Taxable gain resulted to taxpayer in 1934 measured by the difference between the fair market value of the assets acquired under the merger and the basis of the stock of the subsidiary which taxpayer surrendered and cancelled. This gain arose from a distribution in complete liquidation of taxpayer's subsidiary and was taxable under Section 115(c), Revenue Act of 1934. The case does not fall within the exceptions provided in Section 112(b) (4), Revenue Act of 1934. There was no exchange of property solely for stock or securities in *another* corporation a party to the reorganization. Gain is not exempt from taxation merely because a merger is effected under Section 112(g) (i) (A), Revenue Act of 1934. Such gain is taxable unless it arises from one of the nontaxable exchanges enumerated in Section 112. There was no such exchange here.

There are no legal grounds for ignoring the corporate entity of the subsidiary in determining the tax effect of the merger. It was not until the liquidation of the subsidiary in 1934 that any claim was made that the corporations were not separate entities. Separate returns were filed in some years and in others consolidated returns were filed. Taxpayer cannot now be heard to say the corporate entity of the subsidiary should be disregarded. Furthermore, the functions and activities of the subsidiary were more than nominal or passive. It served a definite corporate purpose and had definite activities to perform separate and apart from the activities of the taxpayer.

ARGUMENT.

Introductory.—The undisputed evidence shows that in 1934 pursuant to a statutory merger under the laws of California, the taxpayer acquired the assets of the Gennett Realty Company, its subsidiary [R. 29] and assumed its liabilities, taxpayer surrendering its stock in the subsidiary for retirement and cancellation. [R. 31.] The issue is whether the Commissioner properly recognized gain from the transaction measured by the difference between the value of the assets received by taxpayer and the basis for the stock of Gennett. There is no controversy as to either the basis for the stock, the value of the assets received by the taxpayer or the computation of the amount due if gain is recognizable. [R. 26.] The lower court held [R. 41-42] there was a reorganization under Section 112(g) (1) of the Revenue Act of 1934 (Appendix, *infra*), because of the statutory merger; that because taxpayer owned all of Gennett's stock it was not necessary that Gennett's property should be exchanged for stock in *another* corporation and that upon the surrender and cancellation of the stock taxpayer became entitled to the full benefits of Section 112(b) (4), Revenue Act of 1934. (Appendix, *infra.*) The court further stated [R. 42] that Gennett had no separate corporate existence for tax purposes and that its corporate entity should be entirely disregarded. There was no nontaxable exchange under Section 112, hence it is our contention the taxpayer realized taxable gain upon the merger because of the express provisions of Section 115(c), Revenue Act of 1934 (Appendix, *infra*); and that the corporate entity of Gennett cannot be disregarded.

I.

Taxpayer Received Taxable Gain Through the Distribution in Complete Liquidation of Its Subsidiary.

Section 115(c), Revenue Act of 1934, provides that amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for stock. The gain or loss to the distributee resulting from such exchange is determined under Section 111, Revenue Act of 1934, but is recognized to the extent provided in Section 112, Revenue Act of 1934.

Here there was clearly a liquidation within the meaning of Section 115(c) which made the gain therefrom taxable. *Gutbro Holding Co. v. Commissioner,* 47 B. T. A. 374; *Frelmort Realty Corp. v. Commissioner,* 29 B. T. A. 181; *Ward M. Canaday, Inc. v. Commissioner,* 29 B. T. A. 355, affirmed, 76 F. 2d 278 (C. C. A. 3d), certiorari denied, 296 U. S. 612. The reason for taxing gains resulting from distribution in corporate liquidation as provided in Section 115(c) had its origin in Section 201(c), Revenue Act of 1924, c. 234, 43 Stat. 253. As stated by the Senate Finance Committee, in reference to that section, S. Rep. No. 398, 68th Cong., 1st Sess., pp. 11-12 (1939-1 Cum. Bull. (Part 2) 266, 274), "A liquidating dividend is, in effect, a sale by the stockholder of his stock to the corporation; he surrenders his interest in the corporation and receives money in place thereof." The money or property the stockholder receives differs from the stock interest it previously held and the gain realized is therefore taxable upon the acquisition of this different interest. *United States v. Siegel,* 52 F. 2d 63 (C. C. A. 8th); *Burnet v. Riggs Nat. Bank,* 75 F. 2d 980 (C. C. A. 4th).

The following cases hold that either gains or losses are recognizable upon a liquidation by a parent of its wholly

owned subsidiary. *Burnet v. Aluminum Goods Co.,* 287 U. S. 544 (loss); *Burnet v. Riggs Nat. Bank,* 57 F. 2d 980 (C. C. A. 4th) (loss); *Gutbro Holding Co. v. Commissioner,* 47 B. T. A. 374 (gain); *Frelmort Realty Corp. v. Commissioner,* 29 B. T. A. 181 (gain); *Trenton Oil Co. v. United States,* 41 F. Supp. 887 (E. D. Mich.), affirmed, 122 F. 2d 1023 (C. C. A. 6th) (gain); *Ward M. Canady, Inc. v. Commissioner,* 76 F. 2d 278 (C. C. A. 3d) (gain); *France Co. v. Commissioner,* 88 F. 2d 917 (C. C. A. 6th), certiorari denied, 302 U. S. 699 (gain); *Cerro De Pasco Copper Corp. v. United States,* 13 F. Supp. 633 (C. Cls.), certiorari denied, 298 U. S. 686 (gain).

In *Trenton Oil Co. v. Commissioner, supra,* taxpayer acquired the assets of its subsidiary and surrendered its stock for cancellation. This was not pursuant to a statutory merger but otherwise the facts are similar to those in the case at bar. The District Court held there was no reorganization under Section 112(i), Revenue Act of 1928, but that even if there had been the case did not fall within the exceptions provided in Section 112(b) (4). The court further held there was a liquidation under Section 115(c), Revenue Act of 1928. The District Court was affirmed on appeal.

In *Gutbro Holding Co. v. Commissioner,* 47 B. T. A. 374, there was a statutory merger of the corporation and its subsidiary under the laws of New Jersey and the same question was involved as in the case at bar. The Board of Tax Appeals stated (pp. 380-381):

> All of the assets of the subsidiary corporation did pass to the parent, petitioner, together with all its contractual rights and liabilities, in exchange for petitioner's stock in the parent. The stock was can-

celed. It filed its "Final Return" for Federal income and excess profits tax purposes. Petitioner took its name. The agreement of merger or consolidation which was carried out provided that the existence of the subsidiary should cease except in so far as its continued life was made necessary by statute or for the purposes of that agreement. Neither its continued existence nor any reason therefor is established. The record does not show that it was not dissolved. We think it was in fact liquidated. See *Ward M. Canaday, Inc.*, 29 B. T. A. 355; affd., 76 Fed. (2d) 278; certiorari denied, 296 U. S. 612; *Frelmort Realty Corporation, supra.*

Moreover, whether the acquisition of the assets of its subsidiary by the petitioner was taxable is not controlled by the law of New Jersey, under the jurisdiction of which the statutory merger or consolidation occurred. This must be resolved under the Federal law. *Frelmort Realty Corporation, supra.* Section 115(c) of the Revenue Act of 1934 is determinative. That section, without qualification or limitation, requires that the recognized gain or loss to the distributee from a distribution in liquidation shall be computed under section 112. That section, we repeat, similarly categorically includes "a statutory merger or consolidation" within the definition of reorganization. In our opinion Congress thus clearly indicated that for Federal income tax purposes the present acquisition of the assets of its subsidiary by petitioner in a statutory merger or consolidation was a distribution in liquidation under section 115(c). Cf. *Anna V. Gilmore, supra.* The fact that petitioner received the assets of its subsidiary in connection with the statutory merger or consolidation is of no more significance in construing this section than it

> was in constructing section 112. It follows under section 115(c), *supra,* that, since petitioner is not relieved from tax by any of the nonrecognition provisions of section 112, it was taxable, as determined by respondent, under section 115(c), *supra. Trenton Oil Co. v. United States, supra.*

The evidence in the case at bar clearly shows that taxpayer acquired the assets under a liquidation pursuant to Section 115(c). Liquidation occurs when the assets, rights and liabilities of the merged corporation pass to the surviving corporation. *Guild v. Commissioner,* 19 B. T. A. 1186; *Frelmort Realty Co. v. Commissioner, supra; Gutbro Holding Co. v. Commissioner, supra.*

Under Section 112(g) (1) (A), a statutory merger is a reorganization. While in the case at bar there was a statutory merger this is not enough to entitle the taxpayer to exemption from the admitted gain under Section 112. *National Bank of Commerce of Seattle v. Commissioner*, 40 B. T. A. 72, affirmed, 115 F. 2d 875 (C. C. A. 9th). Taxpayer must bring itself within one of the exceptions to the general rule which is prescribed in Section 112, before it is entitled to postpone taxation of the gain.

In *United States v. Hendler,* 303 U. S. 564, the Supreme Court stated (pp. 566-567):

> Section 112 provides no exemption for gains—resulting from corporate "reorganization"—neither received as "stocks or securities," nor received as "money or other property" and distributed to stockholders under the plan of reorganization. * * *
>
> Since this gain or income of $534,297.40 of the Hendler Company was neither received as "stock or securities" nor distributed to its stockholders "in

> pursuance of the plan of reorganization" it was not exempt and is taxable gain as defined in the 1928 Act. This $534,297.40 gain to the taxpayer does not fall within the exemptions of Section 112. * * *

See *Trenton Oil Co. v. United States,* 41 F. Supp. 887 (E. D. Mich.), affirmed, 122 F. 2d 1023 (C. C. A. 6th); 2 Paul & Mertens, Law of Federal Income Taxation, Sec. 17.47.

The only exception involved here is that provided in Section 112(b) (4) which provides that (1) where a reorganization is effected and (2) where there is an exchange of property for stock in *another* corporation, the gain upon the exchange is not to be recognized. Here there was no exchange of property for stock in *another* corporation and the case is clearly without the provisions of the section.

The lower court cited no authorities to support its desion [R. 41-42], that under the circumstances the taxpayer was entitled to the full benefits of Section 112(b) (4). The decisions are to the contrary. *Gutbro Holding Co. v. Commissioner, supra; Frelmort Realty Co. v. Commissioner, supra; Trenton Oil Co. v. United States, supra; France Co. v. Commissioner, supra.*

Furthermore, at the time of the merger in the case at bar the amendment to Section 112(b), Revenue Act of 1934, by Section 110, Revenue Act of 1935, c. 829, 49 Stat. 1014, was not effective. The amendment provides for nonrecognition of gains and losses through liquidation by a parent corporation of its subsidiary, thus changing the law applicable here. But by its own terms the amendment was not applicable for Congress specifically provided, it shall not apply to any liquidation, if any distribution

in pursuance thereof has been made before the date of the enactment of the Revenue Act of 1935, which was August 30, 1935. See Section 112(b) (6), Revenue Act of 1936, c. 690, 49 Stat. 1648. Though it may be unfortunate that taxpayer did not await until the amendment became effective to effectuate this merger the fact remains it can derive no advantage from the amendment because it was not in effect on the date of the merger.

In order for any taxpayer to take advantage of any of the exemptions under Section 112, it must bring itself clearly within the terms provided in the exceptions. *Helvering v. Southwest Corp.*, 315 U. S. 194. See also Regulations 86, Article 112(a)-1 (Appendix, *infra*).

The transactions did not fall within Section 112(b) (4) as clearly shown by the wording of this subsection. Gain was therefore taxable as provided in Section 112(a), Revenue Act of 1934.

II.

There Are No Valid Grounds for Ignoring the Corporate Entity of the Gennett Realty Company.

The court below was of the view that the facts warranted the ignoring of Gennett's corporate entity. Speaking of Gennett the court stated [R. 42] that it had no substantial separate existence apart from the parent; that its sole object was to hold legal title to certain leaseholds; that during its entire existence with the exception of the years 1922, 1923, 1924 and the year of the merger, 1934, the subsidiary and the taxpayer filed consolidated corporate income and franchise tax returns, and that for these reasons the parent corporation should not be charged with any gain on the acquisition of the assets of the subsidiary through the statutory merger. The lower court

has not enumerated all of Gennett's activities. The evidence shows that Gennett was organized to take title to two 99 year leases [R. 20-21]; that after acquiring the leases it sublet the property to other corporations. [R. 21-22.] In 1922 Gennett issued bonds of $200,000 and raised funds through the bond issue to construct a building on the Pelton lease. The building was constructed out of the funds so raised. [R. 21.] While the evidence does not detail the work that was done in negotiating the bond issue and selling the bonds, planning and constructing the building and handling contracts and other work incident thereto, the corporation was certainly not inactive during these years and cannot be regarded as having no duties or activities or as being a mere sham. The evidence shows that separate federal tax returns were filed during the years 1922, 1923 and 1924, and consolidated returns during the later years except 1934. [R. 23.] During all the years involved rents from subleases were collected by Gennett's trustee and held in account for Gennett. Taxpayer had nothing to do with these rentals or their collection. Gennett took care of interest due on the bonds as well as the retirement of the bonds, all of which was handled by a bank as its agent. [R. 22-23.] Gennett was the obligor on the bonds not the taxpayer. [R. 21.]

In 1934 the taxpayer used Gennett as collecting agent for some of its accounts. Those that were not collected were turned back to taxpayer. [R. 23.] Gennett was organized for a specific purpose. Furthermore, the taxpayer used the separate entity by filing separate tax returns during the years of the greatest activity on the part of Gennett. When it desired to file consolidated returns these were filed. Gennett continued at all times to serve a definite purpose. It was at all times a separate corporation, and had been legally organized with specific

duties to perform. It continued as such until after the merger. It is well settled that corporations within an affiliated group are separate taxpayers and that a wholly owned affiliate is not identical with its parent for tax purposes. *Woolford Realty Co. v. Rose,* 286 U. S. 319; *Commissioner v. General Gas & Elec. Corp.,* 72 F. 2d 364 (C. C. A. 2d); *Commissioner v. Ben Ginsburg Co.,* 54 F. 2d 238 (C. C. A. 2d); *Delaware & Hudson Co. v. Commissioner,* 65 F. 2d 292 (C. C. A. 2d). Taxpayer caused this subsidiary to be created and after securing the desired results caused it to be dissolved. The subsidiary served a purpose during its life and having used it taxpayer must also bear the tax burdens imposed by Congress. It cannot choose to take advantage of the corporate entity for one purpose and have the entity disregarded for another. In *Burnet v. Commonwealth Imp. Co.,* 287 U. S. 415, a corporation transferred its stock to its sole stockholder and the question arose whether this resulted in a loss. The taxpayer claimed the corporate entity should be disregarded. The Supreme Court held that the taxable entity should not be ignored and that the loss was recognizable for tax purposes. The court stated (p. 419):

> Having enjoyed the benefits which resulted from its separate existence, it seeks to perpetuate those benefits and asks that the separate existence and tax liability of the petitioner and its single stockholder be overlooked only with respect to transactions which take place between them. That this is an afterthought is plainly evidenced by the action of petitioner in claiming a deduction upon this same transaction when it believed a deductible loss had been sustained. * * *
>
> "The fact is that petitioner did have a separate legal existence with privileges and obligations entirely sep-

> arate from those of its stockholders. The fact that it had only one stockholder seems of no legal significance. *Cannon Mfg. Co. v. Cudahy Co.,* 267 U. S. 333."

In *Higgins v. Smith,* 308 U. S. 473, the Supreme Court held that even where a taxpayer had used a nominal or fictitious corporation for purposes of tax advantage, it could not later have the corporate entity ignored when ignoring the entity would work to its advantage.

The court stated (p. 477):

> A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages.

We have that situation in the case at bar. Here the taxpayer has freely made use of the tax benefits prescribed by Congress, exercised the elections as to filing consolidated or separate returns and having done so cannot now take a different position when recognition of the entity redounds to its disadvantage. *Higgins v. Smith, supra.* This question was involved in *Texas-Empire Pipe Line Co. v. Commissioner,* 127 F. 2d 220 (C. C. A. 10th), affirming 42 B. T. A. 368. The evidence in that case showed that the only legitimate purposes of the subsidiary were to acquire power of eminent domain in Illinois and reduce tax liability by filing a separate return for 1932. It was held that the transfer of all of the subsidiary's assets to the parent was a liquidating dividend and taxable as such and that taxpayer having elected to organize the subsidiary for legitimate business purposes must accept the attendant tax disadvantages. See also *Atlantic Refining Co. v. United States,* 46 F. Supp. 891 (C. Cls.).

In the lower court the taxpayer relied principally on the case of *Southern Pacific Co. v. Lowe,* 247 U. S. 330. That case is not in point. It involved the Income Tax Act of October 3, 1913, and the question involved was whether dividends which were declared and paid after the effective date of the Sixteenth Amendment out of a surplus which accrued prior to the effective date of the amendment were taxable income to the wholly owned subsidiary receiving the dividends. The evidence showed that the recipient corporation was a separate corporate entity but in reality it had control and possession of the dividends prior to the effective date of the Sixteenth Amendment and under the facts in the case received the dividends before the amendment became effective. Consequently the dividends were not taxable income. The Supreme Court stated (pp. 338-339):

> Under the circumstances, the entire matter of the declaration and payment of the dividends was a paper transaction to bring the books into accord with the acknowledged rights of the Southern Pacific; and so far as the dividends represented the surplus of the Central Pacific that accumulated prior to January 1, 1913, they were not taxable as income of the Southern Pacific within the true intent and meaning of the Act of 1913.
>
> The case turns upon its very peculiar facts, and is distinguishable from others in which the question of the identity of a controlling stockholder with his corporation has been raised. * * *

This case is referred to by the Supreme Court in *Burnet v. Commonwealth Imp. Co.,* 287 U. S. 415, where the court stated (p. 420):

> *Southern Pacific Co. v. Lowe, supra,* and *Gulf Oil Corp. v. Lewellyn, supra* (the latter covered in prin-

ciple by the first), cannot be regarded as laying down any general rule authorizing disregard of corporate entity in respect of taxation. These cases presented peculiar situations and were determined upon consideration of them. In the former this court said [p. 338]—"The case turns upon its very peculiar facts, and is distinguishable from others in which the question of the identity of a controlling stockholder with his corporation has been raised. * * *"

Taxpayer also relied on the case of *Inland Development Co. v. Commissioner,* 120 F. 2d 986 (C. C. A. 10th). The court stated (p. 988):

> It is well settled that in ordinary circumstances, a corporation and its stockholders, whether one or more, are deemed separate entities, and generally that apartness is preserved when dealing with questions relating to taxes. * * *
>
> But it is equally well settled that extraordinary circumstances sometimes exact the disregard of such separateness of entity in the solution of problems relating to taxes. * * *

The unusual circumstances in that case were that the subsidiary owned one oil lease; that the expenses of drilling and operating wells were all paid by the parent company which directly received all income from the lease. Since the parent company received the income the mere fact that this income appeared on the subsidiary's books as dividends paid the parent did not alter the real fact that the income was received from the sale of oil and not as dividends.

Taxpayer also relied on the case of *United States v. Brager Building & Land Corp.,* 124 F. 2d 349 (C. C. A. 4th). In that case the sole purpose of the subsidiary

was to act as a conduit for legal title of property. It was merely the agent of the stockholders in receiving income and the income it received was held to belong to the partnership. While that case seems distinguishable on the facts, nevertheless in so far as it conflicts with the decisions above, we submit the decision is erroneous.

We therefore respectfully urge that under the facts in the case at bar the corporate entity of the Gennett Realty Company should not be disregarded in determining the tax effect of the merger.

Conclusion.

We respectfully urge that the judgment of the District Court be reversed.

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April, 1943.

APPENDIX.

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be rocognized, except as hereinafter provided in this section.

(b) EXCHANGES SOLELY IN KIND.—

* * * * * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) SAME—GAIN OF CORPORATION.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in *another* corporation a party to the reorganization.

* * * * * * * *

(g) DEFINITION OF REORGANIZATION.—As used in this section and section 113–

(1) The term "reorganization" means (A) a statutory merger or consolidation, * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

*   *   *   *   *   *   *   *

(c) DISTRIBUTIONS IN LIQUIDATION.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117(a), 100 per centum of the gain so recognized shall be taken into account in computing net income. * * *

SEC. 702. EXCESS-PROFITS TAX.

(a) There is hereby imposed upon the net income of every corporation, for each income-tax taxable year ending after the close of the first year in respect of which it is taxable under section 701, an excess-profits tax equivalent to 5 per centum of such portion of its net income for such income-tax taxable year as is in excess of 12½ per centum of the adjusted declared value of its capital stock (or in the case of a foreign corporation the adjusted declared value of capital employed in the transaction of its business in the United States) as of the close of the preceding income-tax taxable year (or as of the date of organization if it had no preceding income-tax taxable year) determined as provided in section 701. If the income-tax taxable year in respect of which the

tax under this section is imposed is a period of less than 12 months, such adjusted declared value shall be reduced to an amount which bears the same ratio thereto as the number of months in the period bears to 12 months. For the purposes of this section the net income shall be the same as the net income for income tax purposes for the year in respect of which the tax under this section is imposed.

(b) All provisions of law (including penalties) applicable in respect of the taxes imposed by Title I of this Act, shall, insofar as not inconsistent with this section, be applicable in respect of the tax imposed by this section, except that the provisions of section 131 of that title shall not be applicable.

Treasury Regulations 86 (1934 Ed.):

ART. 112(a)-1. *Sales or exchanges.* The extent to which the amount of gain or loss, determined under section 111, from the sale or exchange of property is to be recognized is governed by the provisions of section 112. The general rule is that the entire amount of such gain or loss is to be recognized.

* * * * * * * *

The exceptions from the general rule requiring the recognition of all gains and losses, like other exceptions from a rule of taxation of general and uniform application, are strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Act only if the exchange is one

which satisfies both (1) the specific description in the Act of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule. The exchange must be germane to, and a necessary incident of, the investment or enterprise in hand. The relationship of the exchange to the venture or enterprise is always material, and the surrounding facts and circumstances must be shown. As elsewhere, the taxpayer claiming the benefit of the exception must show himself within the exception.

* * * * * * * *

ART. 112(g)-1. *Purpose and scope of exception of reorganization exchanges.*— * * * In order to exclude transactions not intended to be included, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule. * * *